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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959.

No. 675

SOLLY K. FRANKENSTEIN AND JULIA E. FRANKENSTEIN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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THE GUNTHORP-WARREN PRINTING COMPANY, CHICAGO

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Petitioners, the plaintiffs-appellants below, respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in the above entitled action on November 18, 1959.

OPINIONS BELOW.

The Opinion of the Court of Appeals for the Seventh Circuit is not yet officially reported but appears as Appendix A to this Petition.

The Tax Court of the United States handed down Findings of Fact and an Opinion, reported at 31 T. C. No. 43, which appear as Appendix B to this Petition.

JURISDICTION.

The judgment of the Court of Appeals was entered November 18, 1959. The jurisdiction of this Court is invoked under 28 U. S. C. A. 1254.

QUESTIONS PRESENTED.

(1) Were profits accruing to Petitioners for the years 1950 to 1954 inclusive, from the sale of vacant lots, acquired by them by purchase at delinquent tax sales, and as investments, taxable as sale of capital assets or as ordinary income?

(2) Was Petitioner, Solly K. Frankenstein, an active practicing attorney devoting forty-eight (48) hours per week to his law profession during the years 1950 to 1954 inclusive, also engaged in the business of selling real estate, because of the sale of vacant lots by petitioners during the years in question?

STATUTES INVOLVED.

The pertinent parts of Section 1221 Internal Revenue Code of 1954 and Section 61, page 20, Internal Revenue Code of 1954, which are involved here, are printed in Appendix C to this Petition.

STATEMENT OF THE CASE.

Petitioners brought this action in the Tax Court of the United States, sitting at Indianapolis, Indiana, for a redetermination of a tax deficiency assessed by Respondent The matter was submitted for trial and after hearing the Tax Court affirmed the assessment. Appeal was had to the Court of Appeals for the Seventh Circuit, where argument was had on the merits, resulting in affirmance of the Tax Court's juudgment on November 18, 1959. Petitioners

filed Petition for Rehearing which was, without oral argument, denied December 22, 1959.

The deficiency assessment grew out of the sales of vacant lots sold by Petitioners, the Respondent contending that Petitioners were engaged in the conduct and operation of a Real Estate business and that all profits from said sales are ordinary income and taxable as such; Petitioners claimed the lots were purchased and held as investments and sale thereof was a sale of a capital asset and any profit accruing was taxable as a sale of a capital asset. The difference in opinion ws resolved in favor of Respondent.

There was substantial undisputed testimony that Solly K. Frankenstein was a practicing attorney actively devoting at least forty-eight (48) hours per week to his law profession; that Petitioners held no license as a real estate dealer; that vacant lots were purchased at tax sales; that the only activity of Petitioners in relation to the sale of lots was to prepare the necessary documents to consummate the sale; that lots were purchased when Petitioners had money and considered the lots a "bargain". The Court of Appeals alludes to the number of lots purchased and sold and the fact that Petitioners' income was greater from the lots sold than from the practice of law as decisive of the conduct of a real estate business. (Appendix 3A.) The Court gives no consideration to the lack of activify on the part of Petitioners in inducing said sales and that said sales were initiated and brought about by others.

REASONS FOR GRANTING WRIT.

The Court of Appeals Erroneously Held That Sale of Vacant Lots by Petitioners, Acquired and Held by Them as Investment, Was in the Ordinary Course of a Real Estate Business Conducted by Petitioners and Profits Accruing from Said Sale Were Taxable as Ordinary Income.

The decision of the Court of Appeals held that sale of vacant lots by Petitioners constituted the operation of a real estate business and such sales were in the ordinary course of that business. The decision is premised on two factors; (1) the number of lots sold and (2) profits arising from said sales were greater than Petitioners' earnings from his profession as an attorney. The decision ignores the purpose for which the lots were purchased, and that the sales resulted from a sudden and unpredicted real estate development in Fort Wayne, Indiana (Appendix 4A), and without any activity on the part of Petitioners in initiating said sales, two factors of paramount importance bearing on the question presented.

Primary Question.

To determine the tax qualification of the profits accruing from the sale of the vacant lots it is vital that it be first determined whether the lots were acquired and held as capital assets, or acquired and held for sale in the ordinary course of a real estate business.

Purpose of Acquisition.

The only testimony bearing on the subject of the lots is that given by Solly K. Frankenstein. He was not cross-examined so his testimony must be accepted as a verity. The Respondent introduced no testimony.

Petitioner Solly K. Frankenstein is a practicing attorney, devoting at least forty-eight (48) hours per week to his practice. He maintains an office for the practice of law and has an extensive library.

He testified that as he had money he made it a practice of investing his money in whatever seemed the best kind of investment; that he made loans to get interest; that he bought stocks on the New York Stock Exchange; that he bought real estate where he thought he was getting a bargain.

This testimony, undisputed and uncontradicted as it is, establishes the practice of accumulating capital assets. The vacant lots purchased at tax sales, by fair inference, were purchased as investments.

Sale of Lots.

The record here discloses the acquisition and sale over a period of fifteen (15) years of a substantial number of vacant lots. It is this number that influenced the Court of Appeals in holding the sales not to be sales of capital assets.

The courts are harmonious in holding that the ascertainment of the definite characteristic of a capital asset in a given factual situation is one of the more substantial zones of difficulty. *Chandler v. United States* (7th Cir., 1955), 226 F. (2d) 403.

The courts have created tests for the determination of the status of property as to whether it is "held by the taxpayer primarily for sale". They are judicially approved guides to be taken into account, although no single test is of itself determinative. *Friend v. Commissioner* (C. A. 10, 1952), 198 F. 2d 285.

The common and usual tests invoked are: intent of the taxpayer; history of the property involved; purpose and method of the acquisition and holding; use and disposition

of the property; lapse of time between acquisition and sale; the number, frequency and continuity of transactions; the activities of the taxpayer in promoting sales, such as making improvements to the property, enhancing its marketability, soliciting customers, conducting a sales campaign, advertising the property to attract purchasers and all other relevant matters going to the ultimate question. *Austin* v. *Commissioner* (C. A. 10, 1959), 263 F. (2d) 460.

The Court of Appeals, with reference to the tests, says:

> "Among the matters to be inquired into are the taxpayer's purposes in acquiring and disposing of the property; the continuity of sales activity; the number, substantiality and frequency of sales; and the owner's activity in developing the property and his efforts to sell." (Appendix 4A.)

The facts in the case are considered in the light of the inquiries of the Court of Appeals. The acquisition and holding of the vacant lots constitute investment—capital assets. Has anything done by Petitioners changed the character of the property?

Continuity of Sales Activity.

Over a period of fifteen (15) years Petitioners purchased vacant lots at tax sales and made no improvements whatever to any lot to enhance its marketability or make it attractive to purchasers. In fact, any improvement undertaken by the city of Fort Wayne of any lot was opposed by Petitioners. (Appendix 8A.) For comparative purposes the lots purchased and sold in the years 1941 to 1955, inclusive, are (Appendix 7A):

Year	Lots Purchased	Total Sales
1941	2	—
1942	37	9
1943	3	1
1944	—	2
1945	4	1
1946	356	8
1947	38	6
1948	347	23
1949	104	18
1950	12	41
1951	58	53
1952	6	43
1953	9	62
1954	5	48
1955	3	—
Totals	984	315

For the years shown Petitioners purchased 984 lots and sold 315. The average annual purchase was less than 66 lots and less than 6 per month. The sales would be exactly 21 lots or less than 2 lots per month. This hardly constitutes frequency of sales. In *Victory Housing #2* v. *Commissioner* (1953), 205 F. (2d) 371, it is held:

> "The fact that 42 units were sold over a period of 6 months does not establish a real estate business or the sales of property in the ordinary course of such business."

Harrum v. *United States* (D. C. Va.), (1958) 164 F. Supp. 650:

Plaintiff in 1939 purchased 84 acres of farm land; this acreage was shown on a plat recorded in 1893; there were 478 small 35 foot lots on the recorded plat. Plaintiff attempted to farm the land but conditions arose making it impractical if not impossible. Plaintiff operated a profitable oil distributing business. Deficiency assessment of

taxes were made for the years 1949 to 1952, inclusive. Plaintiff made some sales in 1945 and the Court set out the sales thereafter:

1946	9 sales covering 40 lots
1947	7 sales covering 32 lots
1948	12 sales covering 41 lots
1949	12 sales covering 31 lots
1950	9 sales covering 28 lots
1951	7 sales covering 21 lots
1952	20 sales covering 54 lots

In addition to these sales plaintiff purchased other land and sold it, but it was contended that these were ordinary sales. The Court said:

> "The *Camp* case (4 Cir. 226 F. (2d) 931), is very nearly analogous to the facts in the instant proceeding. In fact, it may be safely said that there was far more justification to tax the Camp sales as ordinary income because of development factors, the subdividing and platting and the extensive improvements made to cause the property to be more attractive for residential sites. In the case at bar, it would appear that the Government relies almost entirely upon the factor of 'frequency and continuity' of sales—a theory that has been materially refuted in *Farley, supra* (1946—7 T. C. 198), where it is said: 'In the absence of the elements of development and sales activity * * * we are not inclined to think the frequency and continuity test as applied to these circumstances would constitute, in and of itself, a satisfactory criterion of business activity.'"

The Court held the plaintiff had not been engaged in the business of buying and selling real estate and profits were from capital assets.

Impetus for Sales.

The lots purchased by Petitioners were scattered throughout the city of Fort Wayne. A "building boom" was born making the lots desirable for residential purposes; many of these lots were necessary for the developers and in order to acquire them they sought out Petitioners and purchased the lots desired. Petitioners had no connection or relation to the developers or the land being developed. Petitioners had done nothing to make their lots attractive to any purchaser. The sales consummated were initiated by the purchasers and were traceable solely to the building boom. Petitioners' position was absolutely passive. *Houston Deep Water Land Co.* v. *Scofield* (D. C. Tex.) (1952), 110 F. Supp. 394, says:

> "All the sales referred to in footnote 2 above were effected without any sales activity whatsoever on the part of the plaintiff. The property was not listed with real estate agents nor was it advertised for sale. No 'for sale' signs were placed there to enhance its marketability. In each instance, the purchaser sought out the officers of the plaintiff corporation and offered to buy the particular parcel for which such purchaser had a peculiar need. All such offers were considered by the plaintiff, and in those instances where the price was sufficiently attractive, the sales were consummated. * * * The corporate officers have testified and I find as a fact, that it has been the purpose of the corporation since it acquired this property to hold it as an investment; that it was considered by the corporate officers that it would continue to enhance in value; that at all times the corporation has expected eventually to sell the land in small parcels when the time seemed propitious, but that prior to 1944 it had not undertaken to do so and had not embarked on any sales program. At all times the land was for sale, in the sense that, if a purchaser desired a particular tract, and was willing to pay a sufficiently high price, the corporation would sell, etc. Under these facts, in

my opinion, the case is controlled by *South Texas Properties Co.* v. *Commissioner*, 16 T. C. 1003; *Adam Schantz Corporations* v. *Commissioner* (Tax Court, April 29, 1952, as yet unpublished); *Dunlap* v. *Oldham Lumber Co.*, 5 Cir., 178 Fed. 2d 781 and *Farley* v. *Commissioner*, 7 T. C. 198. The first cited authority, on strikingly similar facts, holds that the infrequent sales of unimproved real estate by a corporate tax payer fall within the terms of the capital gains provision. There as here, the tax payer was not actively engaged in the business of buying and selling land. The sales which were made resulted from activity of the purchasers, not the seller, etc."

An analogous situation was before the 9th Circuit in *Austin* v. *Commissioner* (1959), 263 F. (2d) 460, wherein it was said and held:

"Sales were initiated by prospective customers who contacted petitioners through the mail or over the telephone. Negotiations were conducted in the same manner, and petitioner often did not come into personal contact with the purchasers. On some occasions, sales were initiated by brokers who were acting for third parties. People interested in purchasing property in Manhattan Beach would go through the tax rolls to learn the names of property owners. Owners of property received numerous unsolicited inquiries concerning their property. Most of the sales were closed at escrow offices and not at petitioner's office, although on occasions petitioners did prepare the legal documents in connection with the sale in his law offices. Such activity would be that of a lawyer, and not the activity of one engaged in the business of selling real estate. . . .

"Petitioner did nothing to attract prospective buyers. Prospective buyers after checking with tax rolls would seek out the petitioner. The only time or effort devoted by petitioner was after he had been sought out by prospective purchasers or their brokers, and such time and effort related only to negotiations carried on, mostly over the telephone, as to sales prices

and terms. The transactions were consummated by title companies. There is nothing in the record to suggest that such negotiations were extensive or required much effort or time.

"The profits realized by petitioners, as well as the sales, were not the result of any efforts expended by petitioner. After 1945 there was a large amount of real estate development in Manhatten Beach. Persons were seeking to buy lots there, and as a result of such demand petitioners were able to sell lots at substantial prices which he had purchased for relatively small sums or acquired in payment of legal fees. This increase in prices bore no relationship to petitioner's investment or the time he devoted to consummate sales.

"It is our view, based upon the entire record, that petitioner was not engaged in the business of selling real property during the tax years in question, and the properties sold were not being held primarily for sale to customers. The conclusion of the Tax Court in our opinion is clearly erroneous, and on the entire record a mistake has been made."

The only activity of Petitioners was the placing of a homemade "For Sale" sign on lots and the listing of same in the Real Estate For Sale column in a local newspaper for a brief period. Sales could not be traced or attributed to these efforts, except conjecturally or remotely. The housing development extant in Fort Wayne is the responsible source for the sales and the vast majority of the sales were effected during the building boom. The sales were the result of necessity and not of any "activity" or effort of any kind on the part of Petitioners. Chance and fate combined and wedded to Petitioners' benefit. The language of the Virginia and Texas Courts are appropriate. In *Mackell* v. *United States* (D. C. Va.) (1957), 162 F. Supp. 522 at 525, it was said:

"It is certainly true that a person who owns a piece of real estate * * * which in the definition of the

> statute is a 'capital asset' which he wishes to dispose of has the right to do so under conditions which will realize for him the greatest financial benefit. He may sell it off in parcels and over a period of time and he may expend money in improving the property in order to enhance its value and make it more attractive to potential purchasers. And such manner of disposition does not in itself change the nature of the property from a 'capital asset' to something else."

And in similar tenor is *Austin* v. *United States* (D. C. Tex.) (1953), 116 F. Supp. 283 at 286:

> "In my opinion a tax payer may maintain an attitude of willingness to sell and liquidate his long held assets in the absence of any other indicia of real estate activity, without thereby becoming engaged in the real estate business; and this is true whether the amount so sold be large or small. This is the type of fact situation which Section 117 was designed to cover."

The Court of Appeals, in effect, held Petitioners, in addition to the practice of law, to be engaged in the real estate business and that the lots sold were sold in the ordinary course of that business. In *Boomhower* v. *United States* (D. C. Iowa) (1947), 74 F. Supp. 997-1002, it holds:

> "It would seem to carry on a business conveys the idea of progression, continuity and sustained and normally incident activity, and does not mean the performance of simple disconnected acts. Continuity, in the case of real estate enterprise, would hence seem to connote that characteristic of the business of 'going concern' as distinguished from sporadic activity lacking the studied purpose or continuing objective of the entrepreneur-realtor. The occasional purchase and sale of land by an investor speculating on a rise in real estate values does not, in the absence of other circumstances give rise to the status of his being a dealer in real estate. *Biddell* v. *Commissioner* (2 C. 1929), 30 Fed. 2d 622."

In *Fahs* v. *Crawford* (C. A. 5) (1947), 161 F. (2d) 315-316, it is said:

> "* * * Carrying on a business, however, implies an occupational undertaking to which one habitually devotes time, attention or effort with substantial regularity. Merely disposing of investment assets at intermittent intervals, without more, is not engaging in business, even though some preliminary effort is necessary to render the asset saleable. *Snell* v. *Commissioner*, 5 Cir., 97 F. 2d 891."

Petitioners held no license to sell real estate in Indiana; did no personal solicitation for the sale of their lots; employed no one to sell or attempt to sell same; did nothing by way of preparing the lots for sale; did not seek out or search for customers or make effort to attract customers; did absolutely nothing to make their lots more desirable, attractive or marketable, such as improving lots, grading, subdividing, constructing sidewalks, streets, sewers, installing water or electric utilities and the like. The lots remained in the same condition when sold as when originally acquired, a fact that had recognition in *Snell* v. *Commissioner* (C. A. 5) (1938), 97 F. (2d) 891, except as improved by the city of Fort Wayne over the protests of Petitioners. The marketability of the lots sold resulted purely and directly by the action of others, not connected with or related to Petitioners, and to conditions and circumstances not of Petitioners' making, inducement or authority. As a matter of judicial opinion it has been held that the extent of the taxpayer's activity with or concerning the subject matter is the predominating test. *Boomhower* v. *United States* (D. C. Iowa) (1947), 74 F. Supp. 997.

The inquiries suggested by the Court of Appeals when considered in the light of the evidence establish beyond dispute the lack of activity on the part of Petitioners in connection with any sale. Sales without the owner's activ-

ity or effort therein most surely are not the conduct of a real estate business.

It is a matter of common knowledge, shared by this Court, that with the close of World War II a residential building and housing movement was born and cradled by necessity for low cost, yet modern, homes and housing units. To promote this activity and aid in its reality and accomplishment the Federal Government, by appropriate legislation, made money available to the home builder at modest rates of interest. This incentive was recognized by banking institutions who lent their financial support to the project. In almost every city and hamlet in the land, in suburban areas, this building fever reached epidemic proportions; land that for years had lain dormant and useless suddenly was in demand for home sites and the price of its acquisition was an insignificant factor in the general scheme of plans, programs and land developments. The city of Fort Wayne was seized by this movement and home construction mushroomed into a major project. Petitioners' lots being scattered throughout the city, the odds favored much of their holdings. As the development increased and extended to the vicinity of Petitioners' lots, those in charge of this expansion sought out Petitioners and purchased the lots owned by Petitioners located in the path of home site construction. The sales resulted solely because of the location and situation of Petitioners' lots; sales were a direct result of an activity or movement in which Petitioners were not personally involved, had no interest or concern therein or therewith and contributed no effort thereto. Petitioners' attitude was completely passive.

Profits Greater from Sales Than Law Practice.

It is conceded that the Courts give consideration to the extent of profits arising from a source other than the taxpayer's ordinary vocation. But it is not in itself a conclusive factor. In *Mackell* v. *United States* (D. C. Va.) (1957), 162 F. Supp. 522 at 526, it is said:

> "Counsel for the Government emphasize the fact that the income received by each of these tax payers in the years 1948 and 1949 from the sale of their real estate was greatly in excess of that received from other sources. Undoubtedly this is true, but that fact does not prove or necessarily suggest that the property was disposed of in the ordinary course of business."

In this case lots were purchased at a tax sale. It is a matter of common knowledge that the price paid for tax delinquent property equals or is less than the amount of tax due. The lots purchased by Petitioners skyrocketed in value because of a real estate development that made the lots attractive, marketable and necessary. The selling price was fixed by the owner, and as is usual in such circumstances, was fixed on the imperativeness of the demand. Real estate may be purchased as an investment and held until such time as the owner feels it is propitious to sell. If oil is discovered on the land, the value increase is astronomical when compared to the purchase price.

It is established that if a taxpayer sells real estate held as an investment, through a broker, the resulting gain is deemed accruing from the sale of a capital asset. *Smith* v. *Dunn* (C. A. 5) (1935), 224 F. (2d) 353. Why should the rule differ if the sale is made to a developer of real estate at his instance and request?

Conclusion.

The lots purchased at tax sale by Petitioners were investments and held as such; Petitioners made no improvements to the lots to enhance their value or marketability; sales made were initiated and consummated by the purchasers; Petitioners by no act of theirs encouraged or brought about such sales; their position was one of inactivity; their only action in the sale was the preparation of legal documents passing title, a lawyer's work; the sales resulted solely because of a real estate development in Fort Wayne, Indiana; the necessity for more homes was the cause that brought about the sales, a condition that lent itself to all such sales. Petitioners had no license as real estate salesmen, never advertised as such nor held themselves out as realtors. The sales did not result because of anything done by Petitioners, but occurred in the fashion of an accident.

The evidence establishes, without dispute or contradiction the foregoing facts. They logically lead to one conclusion, the sales were sales of capital assets and not sale of lots in the ordinary course of Petitioners' business, as their only business was the profession of law.

The language of *Ross* v. *Commissioner* (C. A. 5) (1955), 227 F. (2d) 265 is peculiarly applicable to the facts at bar:

> "Petitioner on the other hand, offered proof of a convincing character. * * * The nature, character and duration of his title, his active pursuit of the practice of law, the complete absence of 'business' on his part in connection with the sale of these lots beyond the execution of one or two conveyances a month; the undisputed proof that no improvements were made on the property to make it saleable, that no advertising was done and that no sort of effort was made to induce purchasers to buy, all point to the liquidation of a

residuary capital asset by a man who, at most, had attempted to put his savings to work by investment in rental property while following his profession in a normal way."

For each and all of the above reasons, this petition should be granted.

Respectfully submitted,

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APPENDIX A.

OPINION OF THE COURT OF APPEALS.

IN THE UNITED STATES COURT OF APPEALS
for the Seventh Circuit.

No. 12696.

SOLLY K. FRANKENSTEIN and JULIA E. FRANKENSTEIN,
Petitioners,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent,

Petition for Review of Decision of the Tax Court of the United States.

NOVEMBER 18, 1959.

Before DUFFY, KNOCH and CASTLE, *Circuit Judges.*

Castle, *Circuit Judge.* The petitioners, Solly K. Frankenstein and Julia E. Frankenstein, husband and wife reside in Fort Wayne, Indiana. Julia E. Frankenstein is made a party to this proceeding for the reason she filed joint income tax returns with her husband for the years in question. Petitioners filed a joint Federal Income Tax Return for the years 1949, 1950, 1951, 1952, 1953 and 1954 with the Collector of Internal Revenue at Indianapolis, Indiana. These returns were made on the basis of cash receipts and

disbursements. A deficiency tax for each year was assessed. Petitioners filed a petition for redetermination of their tax liability in the Tax Court of the United States. That court sustained the deficiencies except for 1949, it being conceded that the tax for that year was barred by limitations. Petitioners appealed. Hereinafter for convenience Solly K. Frankenstein will be referred to as petitioner.

During the years in question petitioner testified that he put in at least forty-eight hours a week in the practice of law. Petitioner owned lots, some of which were inherited and some of which were purchased. The following schedule shows the real estate acquired by him during the years 1941 through 1955, exclusive of rental properties:

Year	Number of Parcels of Real Estate Purchased
1941	2
1942	37
1943	3
1944	
1945	4
1946	356
1947	38
1948	347
1949	104
1950	12
1951	58
1952	6
1953	9
1954	5
1955	3

The lots purchased during the years 1946 through 1949 were acquired by petitioner at various auctions held by the auditor of Allen County, Indiana. Others were purchased at regular tax sales. Petitioner never sub-divided any of the land into lots, nor did he make any improvements. He

did pay the cost of installing improvements required by public resolutions passed by the City of Fort Wayne. At times there were homemade signs placed on some of the lots containing the words "For Sale" together with a telephone number and his address. Also during the years 1948 and 1949 and until March 1950 he advertised the lots in the real Gazette. Below is a schedule of the number of lots sold outright and the number of lots sold on contract:

Year	Number of Lots Sold Outright	Number of Lots Sold Contract
1942	6	3
1943	1	–
1944	2	–
1945	–	1
1946	7	1
1947	4	2
1948	14	9
1949	11*	7
1950	36*	5
1951	27*	26
1952	28*	15
1953	33*	29
1954	20*	28

* From Income tax return.

During the years here involved most of the transactions were reported on petitioner's income tax returns as separate sales of individual lots. In the majority of cases where lots were sold he would purchase abstracts and furnish them to the purchasers when final payments were made. Petitioner never held a real estate license and was never engaged in the real estate business other than his personal holdings.

As reported on his income tax returns petitioner's gains from the sale of real estate greatly exceeded his income from the practice of law for each of the years involved.

The petitioner reported these transactions on a capital gain basis. The Commissioner determined that the lots were held by the taxpayer primarily for sale to customers in the ordinary course of business, as defined in the exclusion from capital assets provisions, Section 117(a) (1) (A) of the Internal Revenue Code of 1939 and Section 1221 (1) of the Internal Revenue Code of 1954, and that the profits were therefore taxable as ordinary income.

The contested issue argued by petitioner is whether profits derived from the sales of lots during the years here at issue were gains from the sale of capital assets or were income from property held primarily for the sale to customers in the ordinary course of business.

Among the matters to be inquired into are the taxpayer's purposes in acquiring and disposing of the property; the continuity of sales activity; the number, substantiality, and frequency of sales; and the owner's activity in developing the property and his efforts to sell. (*Boomhower* v. *United States*, 74 F. Supp. 997; D. C. Iowa, 1947.) No one factor is conclusive.

Petitioner's income tax returns indicate that the great majority of lots sold were conveyed as separate parcels and transactions. His real estate deals were frequent and substantial and indicative of a continuing business activity, rather than the performance of single disconnected acts. (*Boomhower* v. *United States.*)

Petitioner testified that he devoted at least forty-eight hours a week to the practice of law. However, an examination of his income tax returns shows that his gains from the sale of real estate greatly exceeded his income from the practice of law. In view of the attending circumstances this fact is pertinent. (*Gamble* v. *Commissioner*, 242 F. 2d

586 (C. A. 5, 1957.) After careful consideration of all the evidence we are of the opinion that the petitioner held the lots for the sale to customers in the ordinary course of business.

AFFIRMED.

APPENDIX B.

FINDINGS OF FACT AND OPINION OF TAX COURT OF THE UNITED STATES.

31 T. C. No. 43.

TAX COURT OF THE UNITED STATES.

Solly K. Frankenstein and Julia E. Frankenstein, *Petitioner, vs.* Commissioner of Internal Revenue, *Respondent.*

Docket No. 58106. Filed November 20, 1958.

1. Held, lots sold by petitioners during the years here at issue were held by them primarily for sale to customers in the ordinary course of business and the gains therefrom are taxable as ordinary income.
2. Held, petitioners are not entitled to add the estimated but unpaid expense of acquiring abstracts to the cost of property sold.
3. Held, petitioners are subject to self-employment taxes for each of the years 1951 through 1954, inclusive.
4. Held, respondent correctly determined an addition to tax under section 294(d)(2) of the Internal Revenue Code of 1939 against petitioners for the year 1954.

Dan C. Flanagan, Esq., for the petitioners.

Bernard J. Boyle, Esq., for the respondent.

Respondent determined deficiencies in income tax and an addition to tax under section 294(d)(2) of the Internal Revenue Code of 1939 against petitioners, as follows:

Docket No. 58106.

Year	Deficiency	Addition to Tax Sec. 294(d)(2)
1949	$ 1,834.62	
1950	12,168.48	
1951	8,590.62	
Docket No. 65685		
1952	12,402.12	
1953	25,890.78	
1954	19,846.28	$1,572.23

Respondent concedes that the assessment and collection of the deficiency determined against petitioners for the year 1949 is barred by the statute of limitations. Respondent has made other concessions regarding profits from sales, basis of property sold, and the sales price of various parcels of real estate. Since some of these concessions concern the year 1954, respondent further concedes that there should be a decrease in the addition to tax determined under section 294(d)(2) of the Internal Revenue Code of 1939 for the year 1954. These concessions will be given effect under Rule 50.

Several questions remain for consideration: (1) Whether profits realized by petitioners from the sale of various parcels of real estate are taxable as long-term capital gains or as ordinary income; (2) whether petitioners are entitled to add the estimated expense of acquiring abstracts to the cost of property sold under conditional sales contracts; (3) whether petitioners are subject to self-employment tax for each of the years 1951 through 1954, inclusive; and (4) whether respondent correctly determined an addition to tax under section 294(d)(2) of the Internal Revenue Code of 1939 against petitioners for the year 1954.

Findings of Fact.

Petitioners are husband and wife and reside in Fort Wayne, Indiana. They filed their joint Federal income tax returns for the years 1949, 1950, 1951, 1952, 1953, and 1954 with the collector or director of internal revenue at Indianapolis, Indiana. These returns were made on the basis of the cash receipts and disbursements method.

For convenience, Solly K. Frankenstein will hereinafter be referred to as the petitioner.

Petitioner has been a practicing lawyer in Fort Wayne, Indiana, for many years. During the years 1949, 1950 and 1951 he practiced law with his son, Lester, in the partnership firm of Frankenstein and Frankenstein.

Petitioner inherited some lots and purchased a considerable number of others, mostly in the city of Fort Wayne. The following schedule shows the real estate acquired by him during the years 1941 through 1955, exclusive of rental properties:

Year	Number of Parcels of Real Estate Purchased
1941	2
1942	37
1943	3
1944	—
1945	4
1946	356
1947	38
1948	347
1949	104
1950	12
1951	58
1952	6
1953	9
1954	5
1955	3

The lots purchased during the years 1946 through 1949 were acquired by petitioner at various auctions held by the auditor of Allen County, Indiana. Others were purchased at regular tax sales.

Petitioner never platted any ground into lots, nor made any improvements on lots, nor organized any corporation to develop them. He did pay the cost of installing improvements required by public improvement resolutions passed by the city of Fort Wayne.

Petitioner placed homemade signs which contained the words "For Sale", together with a telephone number and his address, on some of his lots located in areas that were building up. During the years 1948, 1949, and until March 1950, he advertised lots in the real estate "For Sale" column of the Fort Wayne Journal Gazette.

Year	Number of Lots Sold Outright	Number of Lots Sold Contract
1942	6	3
1943	1	—
1944	2	—
1945	—	1
1946	7	1
1947	4	2
1948	14	9
1949	11*	7
1950	36*	5
1951	27*	26
1952	28*	15
1953	33*	29
1954	20*	28

*From income tax return.

During the years here involved most of these transactions were reported on petitioner's income tax returns as separate sales of individual lots.

Petitioner did not receive abstracts with lots acquired

at Allen County auctions or at regular tax sales. In the majority of cases he purchased abstracts for these lots when they were sold. Some of the lots were sold under conditional sales contracts which provided that petitioner was to furnish abstracts when the buyer was ready to make final payment. In rare instances the abstracts were brought up-to-date ahead of time. When reporting some of these sales petitioner estimated the cost of the abstracts and charged them to the cost of sale of the property, even though the abstracts were not paid for until later.

Petitioner never held a real estate license and never engaged in the real estate business other than the sale of his personal holdings, except as a court-appointed commissioner.

As reported on his income tax returns, petitioner's gains from the sale of real estate greatly exceeded his income from the practice of law for each of the years here at issue.

Opinion.

Van Fossan, *Judge*: The first question is whether profits derived from the sale of lots during the years here at issue were gains from the sale of capital assets, or were income from property held primarily for sale to customers in the ordinary course of business.

Petitioner contended that the lots were held for investment and that their sale resulted in long-term capital gains. (1) (Sec. 117 (a), I. R. C. of 1939; sec. 1221, I. R. C. of 1954). Respondent determined that the lots were held by petitioner primarily for sale to customers in the ordinary course of business, as defined in the exclusion from capital assets, (2) (Sec. 117(a)(1)(A), I. R. C. of 1939; sec. 1221(1), I. R. C. of 1954), and that the profits were therefore taxable as ordinary income, (3) (Sec. 22(a), I. R. C. of 1939; sec. 61(a), I. R. C. of 1954).

The issue is one of fact and depends upon all the pertinent facts when placed in proper juxtaposition and given their relative importance. A number of tests have been developed by the courts for making such determinations. Among the matters to be inquired into are the taxpayer's purpose in acquiring and disposing of the property; the continuity of sales activity; the number, substantiality, and frequency of sales; and the owner's activity in developing the property and his efforts to sell. *W. T. Thrift, Sr.*, 15 T. C. 366 (1950). *Boomhower v. United States*, 74 F. Supp. 997 (D. C. Iowa, 1947). No one fact is conclusive.

Petitioner inherited some lots and purchased a number of others, mostly in the city of Fort Wayne. He both purchased and sold real estate in each of the years 1945 through 1955. During the years 1941 through 1954 he purchased 981 parcels of real estate, exclusive of rental properties, 845 of these parcels being acquired in the years 1946, 1947, 1948, and 1949, and being purchased by petitioner at various auctions held by the auditor of Allen County, Indiana. Others were purchased at regular tax sales. Petitioner continued to purchase even as he sold. In 1950 he purchased 12 parcels while selling 41 lots; in 1951 he purchased 58 parcels while selling 53 lots; in 1952 he purchased 6 parcels while selling 43 lots; in 1953 he purchased 9 parcels while selling 62 lots; and in 1954 he purchased 5 parcels while selling 48 lots. Petitioner's income tax returns indicate that the majority of the lots sold were conveyed as single 246 parcels in separate transactions. Clearly, his real estate dealings were frequent and substantial and indicative of a continuing business activity, rather than the performance of single disconnected acts. (*Boomhower v. United States, supra.*)

Petitioner testified at the trial that he devoted at least 48 hours a week to the practice of law. However, his income tax returns show that during each of the years here at

issue his gains from the sale of real estate greatly exceeded his income from the practice of law. This disparity must be given significance. (*Gamble v. Commissioner*, 242 F. 2d 586 (C. A. 5, 1957).) It is self-evident that even though he may have expended 48 hours a week upon his law practice he nonetheless found time to devote whatever efforts were needed to carry on his real estate activity.

Petitioner urges that his failure to advertise extensively is strong evidence that he was holding the lots as an investment. His promotion activities were limited to erection of homemade "For Sale" signs upon some of the lots and to advertising in 1948 and 1949 and part of 1950 in a Fort Wayne paper. However, where there is a seller's market, such as petitioner enjoyed, it is not essential that active sales promotion be demonstrated in order to prove that a taxpayer is engaged in the business of selling real estate. (*Arthur E. Wood*, 25 T. C. 468 (1955).) It should also be noted that in 1948 and 1949, the years during which he advertised in the Fort Wayne Journal Gazette, he purchased 347 and 104 parcels of real estate in such respective years.

Petitioner points out that he never held a real estate license and that he made no effort to improve the lots other than to pay for improvements required by public resolution. However, in the light of the record as a whole we do not regard these factors as controlling.

After careful consideration of all the evidence we are of the opinion that petitioner held the lots for sale to customers in the ordinary course of business. He made substantial sales over a period of years. Even as he sold, he purchased other real estate, lending continuity to his activities. He placed "For Sale" signs on some lots and for more than two years advertised in the "Real Estate for Sale" column of a Fort Wayne paper. Such activities are indicative of a continuing business enterprise. We

therefore hold that petitioner correctly determined profits from the sale of the lots to be taxable to the petitioner as ordinary income.

The second issue before us is whether petitioner is entitled to add the estimated expense of acquiring abstracts to the cost of property sold under conditional sales contracts.

Petitioner did not receive abstracts with the lots acquired at Allen County auctions or at tax sales. In the majority of cases he purchased abstracts for these lots when they were sold. Some of the lots were sold under conditional sales contracts providing that he was to furnish abstracts when the final payment was made.

As we understand it, petitioner, on his income tax returns for the years here in question, reported these conditional sales contracts as installment sales. For the purpose of computing the amount of gain to be realized each year on various of the sales contracts, he included as an expense of sale the estimated cost of preparing abstracts for the property sold. The effect of this treatment was to spread the estimated cost of the abstracts over the terms of the respective contracts.

Section 44 of the Internal Revenue Code of 1939 (4) (The corresponding provisions of the Internal Revenue Code of 1954 are found in section 453) provides, *inter alia*, that when a sale or other disposition of real property is made in which the initial payments do not exceed 30 percent of the selling price there may be returned as income therefrom in the taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

It has been held repeatedly that when real estate is sold by one not a dealer, and the profit is reported on the installment method, the expenses incident to the sale serve to

reduce the selling price in determining the profit to be realized, such expenses thus being spread over the same period as the installment payments; and not being deductible in full in the year of sale. (*Mrs. E. A. Giffin*, 19 B. T. A. 1243 (1930); *D. F. McCrimmon*, 20 B. T. A. 384 (1930); *J. Edward Sullivan*, 23 B. T. A. 137 (1931).)

However, the respondent has consistently provided that "dealers" should deduct selling commissions and other sales expenses as ordinary business expenses in the year of accrual or payment, depending on the method of accounting, and that such expenses should not be spread over the period of the installment payments. (*The Highlands Trust No. 1546*, 32 B. T. A. 760 (1935) reversed on other grounds, 88 F. 2d 355 (C. A. 7, 1937), certiorari denied 302 U. S. 691. See I. T. 2305, V-2 C. B. 108; art. 352, Regulations 74 and 77; art. 44-2, Regulations 86, 94, 101; sec. 19.44-3, Regulations 103; sec. 39.44-2, Regulations 118; and sec. 1.453-4 Income Tax Regulations under Internal Revenue Code of 1954.)

We have already determined that the petitioner in the case at bar was in the business of selling real estate; he was also a cash basis taxpayer. We are therefore of the opinion that those abstract expenses which had not been paid or incurred but merely estimated may not be included in the cost of sale for the purposes of computing gross profit.

The next issue is whether respondent correctly determined petitioner to be liable for self-employment tax for each of the years 1951 to 1954, inclusive. Respondent computed self-employment tax on the income from the realty business for each of these years.

Petitioner is a lawyer. Section 481(c)(5) of the Internal Revenue Code of 1939 and section 1402(c)(5) of the Internal Revenue Code of 1954 as applicable to 1954, exclude from self-employment tax all net earnings gained from the

performance of service by an individual "in the exercise of his profession as a * * * lawyer * * *." However, we have determined that petitioner was also in the business of selling real estate. He is, therefore, required to pay self-employment tax on his earnings as a real estate dealer. (*Joseph M. Philbin*, 26 T.C. 1159 (1956).)

Respondent determined an addition to petitioner's tax under section 294(d)(2) of the Internal Revenue Code of 1939 in the amount of $1,572.23 for the taxable year 1954. Petitioner alleged error as to this determination. However, the issue was not mentioned at the hearing, nor was any evidence submitted in support of petitioner's allegation. In the absence of evidence to the contrary, respondent's determination must be sustained, subject to recomputation to reflect concessions made by the respondent at the hearing.

As to all other issues raised in the pleadings there is almost complete failure of proof. These issues, therefore, must be resolved in favor of respondent, subject to any relevant concessions made at the hearing.

Decisions will be entered under Rule 50.

TAX COURT OF THE UNITED STATES.

(Caption—58106-65685)

ORDER.

It is

Ordered: That the opinion of the Tax Court, filed in the above-entitled cases on November 20, 1958 (31 T. C. No. 43), be amended to correct certain typographical errors as follows:

At the top of page 5 of the mimeograph, immediately preceding the table, add the following paragraph:

> "The value of the lots increased by reason of conditions in the community. As the city developed, the lots in areas attractive for home building were sold by petitioner as follows:"

On page 9 of the mimeograph, line 17, change the word "petitioner" to "respondent", so that the complete, corrected sentence reads as follows:

> "We therefore hold that respondent correctly determined profits from the sale of the lots to be taxable to the petitioner as ordinary income."

ERNEST H. VAN FOSSAN,
Judge.

Dated: Washington, D. C.
November 21, 1958.

TAX COURT OF THE UNITED STATES.

(Caption—58106)

DECISION.

Pursuant to the Court's Findings of Fact and Opinion, filed November 20, 1958, the respondent filed a computation on February 19, 1959, which petitioners agreed under date of March 16, 1959, is in accordance with the opinion.

Ordered and Decided: That there are no deficiencies in income tax for the taxable year 1949; and that there are deficiencies in income tax for the taxable years 1950 and 1951 in the respective amount of $12,168.48 and $8,590.62.

ERNEST H. VAN FOSSAN,
Judge.

APPENDIX C.

INTERNAL REVENUE CODE (1954) (26 U. S. C. A.).

The pertinent portions of the Internal Revenue Code involved are:

Sec. 1221: Definitions. As used in this chapter (1) Capital Assets:

> "The term 'capital assets' means property held by the tax payer, but does not include • • • property held by the tax payer primarily for sale to customers in the ordinary course of his trade or business."

Sec. 61, P. 20. Internal Revenue Code (1954) Gross income:

> "Except as otherwise provided in this sub-title, gross income means all income from whatever sources derived • • • including the following items: • • • (3) gains derived from dealings in property."